

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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|-------------------------------------|---|----------|
| THE APPLICATION OF BLUE GRASS RURAL |) | |
| ELECTRIC COOPERATIVE CORPORATION TO |) | CASE NO. |
| TO REFINANCE AND CONVERT LOANS FROM |) | 92-284 |
| FIXED TO VARIABLE RATE |) | |

O R D E R

On July 6, 1992, Blue Grass Rural Electric Cooperative Corporation ("Blue Grass") filed a request that the Commission amend its prior Orders entered in Case No. 7863,¹ Case No. 8726,² and Case No. 9155³ to authorize the conversion from a fixed to a variable interest rate for National Rural Utilities Cooperative Finance Corporation ("CFC") Loan Nos. 9009, 9018, and 9019. The terms of these 35-year loans originally provided for a fixed interest rate for the first 7 years, after which, the rate would be

¹ Case No. 7863, The Application of Blue Grass Rural Electric Cooperative Corporation for Certificate of Public Convenience and Necessity to Execute Its Note to the United States of America in the Amount of \$1,815,000.00 and to Execute Its Note to National Rural Utilities Cooperative Finance Corporation in the Amount of \$819,000.00, Order dated August 25, 1980.

² Case No. 8726, The Application of Blue Grass Rural Electric Cooperative Corporation for Certificate of Public Convenience and Necessity to Execute Its Note to the United States of America in the Amount of \$1,090,000.00 and to Execute Its Note to National Rural Utilities Cooperative Finance Corporation in the Amount of \$492,000.00, Order dated December 2, 1982.

³ Case No. 9155, The Application of Blue Grass Rural Electric Cooperative Corporation for a Certificate of Public Convenience and Necessity to Execute Its Note to the United States of America in the Amount of \$2,100,000 and to Execute Its Note to National Rural Utilities Cooperative Finance Corporation in the Amount of \$947,000, Order dated November 21, 1984.

renegotiated. Since the execution of these loans, interest rates have been substantially reduced and CFC has allowed borrowers to convert to a reduced variable interest rate. The current fixed interest rate for these loans was 9.5 percent, 10.0 percent, and 9.0 percent, respectively. The variable rate applicable for these loans is 5.5 percent. On July 1, 1992, Blue Grass' Board of Directors voted to convert to the variable rate.

When converting from the fixed rate program to the variable rate program, CFC requires the payment of a conversion fee. The conversion fee for each loan is based on the difference in the interest rate on the note and CFC's long-term interest rate at the time the borrower elects to convert to the variable rate. The difference is applied to the outstanding loan balance at the start of the borrower's next first full quarterly billing cycle for the time remaining until a repricing option would have been allowed. A one-time, up-front fee of 25 basis points on the outstanding balance at the time of conversion is added to the conversion fee. The conversion fee could be paid either in quarterly payments or as a discounted up-front payment. The total conversion fee would be \$69,784 if paid quarterly and \$61,686 if paid up-front.

Blue Grass provided a series of Internal Rate of Return ("IRR") analyses for each loan it proposed to convert. Under the IRR approach, the goal of the borrower would be to utilize the interest rate program which produces the lowest IRR. For each loan, Blue Grass determined an IRR value for the following three different scenarios:

1. The current variable rate remained constant for the remainder of the pricing cycle ("Scenario I").

2. The current variable rate would begin increasing by .25 percent each quarter, beginning with the second quarter after conversion, for the remainder of the pricing cycle ("Scenario II").

3. The third scenario involved determining the variable interest rates which, when applied beginning with the second quarter after conversion, would result in an IRR value approximately equal to the IRR value resulting from the current fixed interest rate. Blue Grass considered this the break-even scenario.

Each scenario was run twice showing the impact on the IRR value of each payment option chosen for the conversion fee.

The analysis indicated that, under either Scenario I or II, the resulting IRRs for the variable interest rate were lower than the IRR for the fixed interest rate. The scenario results also indicate it is beneficial to Blue Grass to pay the conversion fees up-front rather than quarterly. Scenario I resulted in a net cumulative savings of \$71,383 when the conversion fees were paid up-front and \$63,285 when the conversion fees were paid quarterly. Scenario II resulted in a net cumulative savings of \$13,031 when the conversion fees were paid up-front and \$4,933 when the conversion fees were paid quarterly. The net savings were lower in Scenario II because two of the three loans had 14 or more quarters remaining in the current pricing cycle. Under the assumptions incorporated in Scenario II, the increasing variable interest rate

on individual loans resulted in significantly lower savings and in some instances a net increase in cost.

In its request, Blue Grass indicated that it would pay the conversion fees using the discounted up-front payment option. Blue Grass stated that it viewed the assumptions in Scenario II to be a "worst case" scenario. Blue Grass provided an analysis of historic CFC interest rates and interest rate projections covering the next several financial quarters. The projections indicated no major fluctuations were expected in interest rates during the period. Blue Grass indicated that it would constantly monitor the variable interest rates and would shift to the fixed interest rate program in the future if indicators showed it to be advantageous. Based upon Blue Grass' analyses and the conditions presented in this case, the conversions of the three loans should result in interest savings on an IRR basis and the loans should be converted as requested.

IT IS THEREFORE ORDERED that:

1. The Commission's Orders entered in Case Nos. 7863, 8726, and 9155 be and they hereby are modified to authorize the conversion from a fixed to a variable rate program for CFC Loan Nos. 9009, 9018, and 9019.

2. Blue Grass shall notify the Commission of the closing date of the conversions and shall file, within 30 days of the conversions, all documents pertaining thereto.

3. Blue Grass shall file, along with its monthly financial report to the Commission, the current interest rate on its variable rate loans outstanding.

4. All provisions of the Commission's Orders entered in Case Nos. 7863, 8726, and 9155 shall remain in full force and effect.

Done at Frankfort, Kentucky, this 20th day of August, 1992.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:


Executive Director